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The Role of Agricultural Cooperatives
in the European Union:
A Strategy for Cypriot Accession?

SUSAN SENIOR NELLO

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A Strategy for Cypriot Accession?**

SUSAN SENIOR NELLO

Università di Siena

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1.Introduction

Agricultural cooperatives have a long tradition in the European Union, and in recent years they have been rising in number. Cooperatives may offer various advantages such as improving the bargaining power of farmers, stabilising prices, allowing economies of scale to be exploited, or offering guarantees with regard to quality. The aim here is to see how far agricultural cooperatives could play a role in helping one of the applicant countries, Cyprus, prepare for EU membership.¹

When Cyprus² joins the EU its agriculture will have to compete in a Community-wide single market. Adopting the Common Agricultural Policy (CAP) is likely to lead to increases in prices for many agricultural products. Higher prices impose a burden on consumers and the food industry using agricultural inputs. The key to offsetting the negative consequences of increases in farm gate prices, and enabling Cypriot farmers and food industries to withstand the additional competitive pressures of an enlarged EU, is to increase efficiency. This would also enable Cypriot agriculture to overcome some of the drawbacks of a dry climate, and small, fragmented farms. The aim here is to assess how far cooperatives could assist Cyprus in this task.

When Cyprus joins the EU, the mechanisms used for agricultural policy will have to be brought in line with those of the CAP. This entails introducing certain new institutions, such as the organisation of producer groups in sectors such as fruit and vegetables, and abolishing others such as the marketing boards.³ Cooperatives could play a role in facilitating this process of adjustment.

¹This paper was prepared for a seminar organised by the European Institute of Cyprus (EIC) attended *inter alia* by representatives of Cypriot agricultural cooperatives and cooperative banks. I would like to thank the EIC for their invitation, and for the lively discussions which ensued. The usual disclaimer of course applies.

²In 1987 the EU signed a customs union agreement with the government of Cyprus on behalf of the whole island. This is expected to happen with accession, even though the Government of Cyprus cannot give any guarantee of the *acquis communautaire* being adopted in the Turkish part of the island (Pattichis, 1999). The *acquis communautaire* is the body of EU legislation, practices, principles, and objectives accepted by the member states. It is composed of the Treaties (and, most importantly, the Treaties of Rome, the Single European Act, the Maastricht Treaty and, following ratification, the Amsterdam Treaty); legislation enacted at the EU level and judgements of the European Court of Justice; Justice and Home Affairs; Foreign and Security Policy and Treaties of the EU with third countries. The *acquis* has been accumulating over the years and now amounts to some 12,000 legislative acts.

³Marketing boards are semi-government agencies responsible for ensuring adequate domestic supply and handling exports.

In order to illustrate how this is the case Section 2 describes the main characteristics of agricultural cooperatives, while Sections 3 and 4 deal with the EU experience of cooperatives and producer organisations respectively. Section 5 indicates some of the difficulties encountered by agricultural cooperatives in the EU. Sections 6 and 7 describe the main features of Cypriot agricultural production and trade, while Section 8 indicates how the agricultural policies adopted in Cyprus would have to be brought in line with EU market organisations. Section 9 discusses the experience of cooperatives in Cyprus, before reaching conclusions about how cooperatives could help Cyprus to prepare for EU accession in Section 10.

2. The Characteristics of Agricultural Cooperatives

Following Bonin, Jones and Putterman (1993, p.1291), cooperatives can be defined by their free and voluntary membership, and by having three characteristics associated with worker control: participation in firm decision making (including the appointment of management), profit-sharing, and employee ownership.⁴ Though the internal rules and policies of cooperatives vary considerably, certain common practices can be identified.⁵ In particular, certain percentage of the surplus (i.e. revenues in excess of costs, including contractual wage payments) is distributed to the members as "bonus" payments in all cooperatives.⁶ After wages and other costs are paid, the remaining surplus may be divided between individual capital accounts, and a collective capital fund. In most cooperatives the bulk of capital financing for investment tends to come from the collective capital funds.

As van Bekkum and van Dijk et al (1997) argue, the long tradition of cooperatives in the agricultural sector, can be explained by certain intrinsic characteristics of agriculture and rural life.⁷ For the most part farms are small relative to their industrial counterparts, while the food processing and farm input industries are often highly concentrated. Consumers of food products are becoming increasingly concerned about the safety, quality and variety of foodstuffs. The dependence of agriculture on climate and biological factors inevitably leads to uncertainties in the quantity and quality of supply. The

⁴The definition of cooperatives evolved by the US Department of Agriculture in the 1980s which is widely used (also by van Bekkum and van Dijk eds., 1997) defines these characteristics in slightly different terms: a cooperative as a firm which is controlled by its users, owned by its users, and which distributes benefits on the basis of use.

⁵See also Bartlett and Uvalic (1986).

⁶Members are rarely paid interest on their shares, but instead receive these equity gains.

⁷These authors maintain that the usefulness of cooperatives in agriculture is likely to remain precisely because it depends on these structural features of agriculture and rural life. However, this does not mean that agricultural cooperatives will remain unchanged in their present form, as adjustment to the rapidly evolving context in which they operate is necessary.

nature of agricultural production means that farmers are geographically dispersed, and often far from markets.

Agricultural cooperatives are said to offer various advantages:⁸

- They may improve the bargaining power of farmers relative to input suppliers and processors so enabling market outlets to be guaranteed, and margins to be enhanced.
- Cooperatives may permit farmers to exploit economies of scale.
- They may provide an institutional framework for preventing prices from falling too low as a result of excess supply, and help farmers to cope with the uncertainty arising from the dependence of agriculture on climate and biological factors.
- Cooperatives may permit access to new markets.
- Cooperatives for marketing and processing may enable improvements in quality, in particular for products subject to considerable variability such as fruit and vegetables. Increasingly cooperatives tend to impose strict standards and controls on the quality of their products, and in some cases provide certification concerning the origin of the product.
- The formation of cooperatives may create employment, and raise the incomes of farmers.
- At times the formation of cooperatives has been favoured for political or social motives.⁹
- It is also argued that cooperatives may offer transaction-cost advantages as a means over overcoming opportunism and hold-ups. With regard to transaction costs, Williamson (1981) has argued that organisations may incur high costs if they have asset-specific investments and encounter opportunistic behaviour on the part of their partners. Both farmers and food processors have a high share of investments in specific assets, i.e. assets with a very low value in alternative uses. Both are therefore vulnerable to opportunistic

⁸The argument that cooperatives increase productivity by improving incentives, which is central to the literature on industrial cooperatives (see, for example, Bonin, Jones and Putterman (1993)) appears less often in the literature on EU agricultural cooperatives as these are mainly concerned with upstream and downstream activities.

⁹For instance Giacomini, Bonomi, and Martorana (1996) describe how this was the case in Italy during the Fascist era.

behaviour, which might be reflected in the terms or renewal of contract, or in the fixing of prices. Cooperatives may offer advantages in enabling more trustworthy partners to be chosen, or binding contractual relations in statutory arrangements (Kyriakopoulos and van Bekkum, 1999).

- Cooperatives may help to address the problems of asymmetric information regarding the safety and quality of food, and the compliance of production methods with objectives such as protecting the environment, or respecting animal welfare. Asymmetric information is a type of market failure in which there is an asymmetry of information between buyer and seller (Akerlof, 1970). Many goods produced by the agri-food industry can be defined as "credence goods", as their quality cannot be discerned by consumers before or after they are purchased (Caswell and Mojduska, 1996). As consumers are unable to distinguish the quality good, they may choose the lower quality good and, by Gresham's law, drive those of higher quality from the market (Blandford and Fulponi, 1999). Cooperatives may play a role in ensuring that consumers are guaranteed the product that they expect.

3. Agricultural Cooperatives in the EU

In the EU cooperative arrangements in agriculture generally relate to marketing and processing activities, or farm inputs and the provision of credit rather than the actual production process (see Tables 1 and 2). Investment in upstream or downstream activities is generally beyond the financial means of individual farmers, so farmers band together in joint vertical integration.

Despite difficulties in measurement (also due to the variety of activities in which cooperatives are involved) the use of agricultural cooperatives seems to be in expansion in the EU,¹⁰ in particular, in Germany with the transformation of over a thousand former state-owned farms into cooperatives. Cooperatives continue to be organised on a national basis, though some have foreign members,¹¹ and many are active on international markets.

Cooperatives concerned with marketing and processing can be divided into "first-stage" cooperatives which buy from the farmer, and which may carry out initial processing, and second stage cooperatives, or confederations, which may coordinate the marketing of a number of first-stage cooperatives and carry out further processing.

¹⁰Van Bekkum and van Dijk et al (1997)

¹¹For instance, the German dairy cooperatives have Belgian members, while British fruit and vegetable cooperatives have admitted Spanish members in order to increase the variety of their supply (van Bekkum and van Dijk eds., 1997).

Table 1: Agricultural Cooperatives in the EU in 1996

	Number of cooperatives	Number of members	Turnover of cooperatives 1000 ECU
Belgium	n.a	n.a	n.a
Denmark	214	113,000	12.1
Germany	3,950	3,280,000	39.3
Greece	6,919	728,000	0.85
Spain	4,350	950,000	6.3
France	3,618	720,000	52.6
Ireland	128	186,000	9.59
Italy*	8,850	1,124,000	16.45
Lux.	25	n.a.	0.12
Netherlands*	251	273,000	22.4
Austria	1,757	2,182,000	n.a.
Portugal	909	800,000	1.27
Finland	403	1,228,500	7.59
Sweden	50	300,000	8.24
UK	506	271,000	7.66

Source: van Bakkum and van Dijk et al (1997)

*1995

In recent years there has been a decline in the number of these second stage cooperatives or confederations in the EU due to problems of coordination and control, which result in a loss of competitiveness *vis-à-vis* individual cooperatives (van Bakkum and van Dijk eds., 1997). This tendency has been reinforced by the spate of mergers and acquisitions by first-stage cooperatives in EU countries aimed at increasing competitiveness.

Some cooperatives have tried to increase the income of their members by shifting to the production of goods with higher value added, and this frequently leads to vertical integration or the development of own brand names. Increasingly cooperatives recognise the importance of market orientation and the development of specialised regional products. None the less, in volume terms most agricultural cooperatives continue to deal with products which have not been processed, or only partially so.

In the EU cooperatives for the marketing and processing of agricultural products have played an important role in sectors such as milk, fruit and vegetables, wine, and olive oil. As shown in Table 3, in some countries cooperatives have also been significant in sectors such as cereals, and pigmeat. In general, however, as the Table illustrates, the share of agricultural produce sold through cooperatives tends to be lower in Mediterranean countries, and, as will be shown below, Cyprus appears more in line with the Mediterranean averages.

Table 2: The 20 Main Agricultural Cooperatives in the EU (1995)

cooperative	country	product group	turnover 1000 ECU	number of members	number of employees
1. Baywa	Germany	multi- functional	3,542,000	n.a.	10,794
2. Metsaliitto	Finland	wood	3,133,000	117,783	n.a.
3. Campina Melkunie	NL	dairy products	3,100,000	9,500	6,549
4. Sodiaal	France	dairy products	2,565,000	n.a.	n.a.
5. Milk Marque	UK	dairy products	2,393,000	18,000	300
6. Cebeco Handelsrand	NL	inputs and agricultural production	2,190,000	50	4,416
7. Friesland Dairy Foods	NL	dairy products	2,000,000	4,800	7,490
8. Socopa	France	Meat	1,990,000	n.a.	n.a.
9. RHG Hannover	Germany	multi- functional	1,790,000	260	2,946
10. Coberco	NL	dairy products	1,760,000	9,200	3,668
11. MD Foods	Denmark	dairy products	1,681,000	8,919	3,678
12. Danish Crown *	Denmark	meat	1,576,800	12,560	6,965
13. UNCAA#	France	inputs, meat	1,527,900	n.a.	n.a.
14. The Irish Dairy Board	Ireland	dairy products	1,523,300	71	2,010
15. Avonmore	Ireland	dairy products	1,494,300	13,245	6,426
16. Kerry Group	Ireland	dairy products	1,463,300	6,000	6,407
17. Dumeco*	NL	meat	1,401,000	16,500	3,000
18. Valio	Finland	dairy products	1,397,000	47	5,101
19. Arla	Sweden	dairy products	1,369,000	10,365	6,020
20. Greenery/VTN*	NL	fruit and vegetables, auctions	1,346,600	17,850	5,274

Source: van Bekkum and van Dijk et al (1997)

* 1996

1995/6

Table 3: Agricultural Products Sold through Cooperatives in the EU (1995)

	pig- meat	beef/ veal	poultry	eggs	milk	sugar- beet	cereals	all fruit	all veg.
Belgium	18	-	-	-	60	-	30	75	85
Denmark	96	66	54	56	98	-	59	70-80	70-80
Germany	27	27	-	-	48	80	30-50	20-40	55-65
Greece	3	2	15	2	20	-	49	57	3
Spain	5	6	14	18	18	20	17	37	12
France	85	30	30	25	47	16	68	40	25
Ireland	66	15-20	20	-	99.5	-	57	14.3	17.5
Italy*	13	12	35	8	40	6.5	20	43	8
Lux.	35	25	-	-	81	-	75	-	-
Netherlands*	40	31	10	13	84	63	65	85	67
Austria	20	25	70	-	90	100	60	18	28
Portugal	-	-	-	-	-	-	-	-	-
Finland	66	64	82	60	96	-	48	-	-
Sweden	78	76	-	33	99	-	75	20	50
UK	28	-	-	25	98	-	21	25	34

* 1994

Source: The Situation of Agriculture in the European Community, 1997

At the EU level, the umbrella organisation for agricultural cooperatives is the COGECA (General Committee for Agricultural Cooperation in the EU).¹² In 1994 COGECA represented through its 16 national association members some 33,000 agricultural and fisheries cooperatives in the EU. The cooperatives were composed of more than 14,000,000 cooperative members. These supplied over half of the farm inputs in the EU, and were responsible for marketing and processing over 60% of output.

4. Producer Organisations in the EU

The EC Commission has always been in favour of measures to improve the bargaining power of farmers in the market place, in particular, by encouraging the formation of producer organisations.¹³ The attitude of the Commission was also influenced by the positive experience of certain of the member states with such organisations, as, for example, the *Groupelements de producteurs* in France and the *Veilingen* in the Netherlands.

¹²COGECA maintains a joint staff with COPA (Committee of Professional Agricultural Organisations which is the main federation of farmers' groups in Brussels), and CEJA (the European Council of young farmers). COGECA, together with COPA was formed in 1959 at the bequest of the EC Commission to help coordinate farm policy at the EC level. It participates in the agricultural decision-making process of the EU and has regular contacts with the EC Commission, the Agriculture Committee of the European Parliament, and the secretariat of the Council of Ministers, and Ecosoc.

¹³Such measures were considered an exception to Article 85 of the Treaty of Rome which deals with anti-competitive practices.

The first measures granting financial assistance for the formation and operation of voluntary producer organisations were introduced in the fruit and vegetable sector (Reg.159/66).¹⁴ Subsequently measures to encourage the formation of producer groups were introduced for other sectors,¹⁵ but it was not until 1978 that an overall Regulation (1360/78) on "producer groups and associations thereof" was introduced.¹⁶ This measure was initially conceived for Italy, but was in the event was extended to certain French Departments (mainly in the South), French overseas Departments, and Belgium. The coverage varied by area, but included products such as citrus fruit, wine and grapes, olives, cereals and live cattle.

The present legislation dates from 1996 with Reg. 2200/96, which sets out the objectives of producer organisations as being:

- managing supply and organising it better in the face of increasingly monopolistic demand;
- recognition of the role of the market;¹⁷
- taking account of environmental concerns, and
- reinforcing product standards.

Producer groups are encouraged to join together in inter-professional associations, and together these were granted powers to organise market support. They are responsible for determining rules regarding minimum prices

¹⁴This legislation was consolidated by Reg. 1035/72, according to which the aims of such organisations were:

- i) to help to concentrate supply and stabilise producer prices;
- ii) to assist members in the presentation and marketing of produce;
- iii) unless the requirement is waived, to sell the members' total output, in respect of which they joined the group, and
- iv) to adopt measures to improve quality and to adapt supply to market requirements.

Member states were granted the power to grant launching aids to producer groups in the first three years of their establishment (extended to 7 years for Mediterranean countries in 1978, given the particular difficulties of their agriculture). Aid was granted as a certain percentage (descending from 3% to 1% in the 1972 Regulation) of the value of produce supplied by the members.

¹⁵Regulations were introduced to encourage the formation of producer groups in fisheries (1970), hops (1971), silkworm production (1975), and olive oil (1978).

¹⁶According to Regulation 1360/78, aid was given to organisations recognised by individual member states and was recognition was conditional on the organisation having a certain minimum size, being able to implement norms for the production and marketing of agricultural products, and marketing all the produce of members, or at least deciding on norms for doing so.

The Italian legislation (674/78) envisaged two further roles for producer organisations: participation in drawing up national and regional agricultural plans, and representation of their members, in particular in agreeing contracts with downstream firms and their associations.

¹⁷It was widely recognised that the policy of withdrawals had the negative tendency of transforming short-term surpluses into structural ones.

and terms of compensation for withdrawn products, and for the management of withdrawals. Producer organisations therefore play a key role in administering the system.

EU financing for these activities is conditional on recognition, and under Regulation 2200/96, the criteria for recognising producer organisations became more restrictive. Producer organisations must have a minimum number of members,¹⁸ control a certain quantity of output, and respect certain statutory and technical conditions. Producers must belong to just one producer organisation and (with a few exceptions, such as allowances for direct sales) sell all their produce through it.

Producer organisations are required to set up operational programmes to improve product quality, marketing, develop environmentally-sound cultivation practices and so on. Approved programmes are part-financed by FEOGA (on a 50:50 basis).¹⁹ Withdrawal operations only receive Community financing if the operational programme has been approved.

The experience of EU member states illustrates that the creation of producer organisations has generally gone more smoothly and their operation has been more effective where there is a tradition of cooperatives.²⁰ As Ledermann (1998) describes, the fact that many producer organisations sprang from cooperatives helps to explain the success of producer organisations in certain French regions such as Brittany, Nord Picardie, and Val de Loire.

In some cases producer organisations have been set up with no real commercial role, but simply to carry out withdrawals and receive subsidies in

¹⁸Recognising that previous measures had limited success in the consolidation of supply, the later measures also allowed national legislation to fix a higher minimum thresholds for recognition of producer organisations. Countries such as the Netherlands, France and Spain adopted the thresholds of the EC Regulation, but Italy fixed far higher levels. To qualify for recognition, Italian producer organisations were to have 100 rather than the minimum of 40 members specified by Reg. 412/97, and a turnover of 10 rather than 1.5 ECU. Prior to the 1997 Regulation a large number (148) of relatively small producer organisations were operating in the Italian fruit and vegetable sector, controlling about 30% of production, but subsequently the number fell to 65 and they controlled only 19% of the production of fruit and vegetables. Moreover, only 49 of these producer organisations were able to present the operating programmes required to obtain Community financing, and very few of these were in the South, where 68% of fruit and vegetables are produced. In contrast, the share of fruit and vegetable production covered by the 1997 EC Regulation was 70% in the Netherlands, 42% in France, and 25% in Spain (Bruni, 1999).

¹⁹ Up to 4%, increased to 4.5% from 1999, of the value of marketed production.

²⁰ At the EU level it was always stressed that the role of producer organisations was to support rather than substitute cooperatives, but in practice the relationship between producer organisations and cooperatives has always been rather ambiguous as emerges from the discussion here.

consequence.²¹ As a result their functions were reduced to the bureaucratic aspects of implementing Community norms.²² Producer organisations can either operate directly, buying produce from their members and taking part in market operations, or they can rely on their members to carry out these actions, provided common objectives are met. As a result, decisions concerning the quantity of production to market, the programming of production, or even information about the amount of production being released on the market over time often remain the prerogative of members. Where producer groups number cooperatives among their members, they tend to rely on these cooperatives to carry out actual marketing. As a result, it is often the cooperative members rather than the producer group who are in a stronger position to realise the objectives listed above. Not surprisingly many producer organisations encourage the formation of cooperatives to render their operations more effective (Malevolti, 1989).

The creation of cooperatives in sectors such as fruit and vegetables in Cyprus could therefore help to render the future operation of Cypriot producer groups in an enlarged EU more effective, transforming them from simple units for administering Community norms, into organisations capable of concentrating and controlling supply, and improving its quality.

5. The Difficulties Encountered by Agricultural Cooperatives in the EU

It is frequently argued that the effectiveness of cooperatives is undermined because their specific characteristics create conflicts with regard to governance structures, residual claims and the ability to ensure adequate financing for capital investments.²³ It is useful now to provide a brief review of the various explanations offered as to why such conflicts might arise.²⁴

Cooperatives are collectively owned and, as Olson (1965) described, where property rights are collective or unassigned, a *free-riding problem* may occur.²⁵ For example, non-members may be able to capture the benefits of terms of trade negotiated by members of the cooperative. A more complex form of free riding may arise because, in general, a member leaving a cooperative is not

²¹See Ledemann (1998) for the case of France, Aldanondo Ochoa (1998) for Spain and Malevolti (1989) or Rama and Lanciotti (1997) for Italy.

²²This is a problem, in particular, in sectors such as olive oil, or the production of tomatoes for processing.

²³See, for instance, Gow and Swinnen (1997).

²⁴For a more detailed account of this issue see the taxonomy of problem sets provided by Cook (1995).

²⁵Current members of the cooperative use resources for their own benefit and the attribution of property rights is not adequate to ensure that current members bear or receive the full costs and/or benefits of their actions.

entitled to take his full contribution to collective capital. As a result there is a *common property problem* (Vitaliano, 1983), and members will be reluctant to contribute to investments whose benefits are not appropriable in proportion to their costs.

The application of the property-rights approach to cooperatives owes much to the pioneering work of Furubotn and Pejovich (1970) and Vanek (1977). Independently these authors identified a disincentive to finance investment with internal funds when members of the cooperative do not have individual and transferable ownership rights in the assets of the cooperative. Rather than using the current surplus to finance capital investment, workers prefer to distribute as much as possible to themselves in the form of wages or bonuses.

This disincentive to retain funds for investment purposes may be exacerbated by the *horizon* problem which arises because the member has a claim to returns on an asset only as long as he is a member of the cooperative, and this may not coincide with the productive life of the asset.

A *portfolio* problem may arise when there is no secondary market for shares in the cooperative (Vitaliano, 1983). If ownership rights are not tradable, patrons cannot achieve a portfolio of investments which reflects their risk preferences, and this may increase risk aversion towards investments.²⁶ Lack of transferability means that members hold suboptimal portfolios, and those who are forced to accept more risk than they prefer may encourage the decision-makers of the cooperative to reduce risks, even where this means lower expected returns on investments (Cook, 1995).

According to the *principal-agency approach*, it is frequently argued that problems for the governance of cooperatives may arise from the separation of ownership and control giving rise to diverging objectives of the members of a cooperative and its management.

Coordination of the activities of a cooperative are carried out according to the organisational arrangements set out in its statute. According to the democratic principle, members should be directly and exclusively involved in decision-making, but in practice members are generally represented by a board of directors. A control problem may arise as a result of diverging interests between the board of directors (principal), and the management (agency).²⁷

²⁶Relatively poor worker-managers may also prefer projects with lower risk.

²⁷The case is somewhat different for investor-owned firms. In small firms the owner is generally also the manager so corporate governance is relatively straightforward. The difficulty arises with larger firms where there is a divorce between ownership and control. There are two main models of corporate governance for investor-owned firms. The Anglo-

The *influence-cost* problem may arise if the cooperative engages in diverse activities and members have a wide range of objectives. Influence activities arise when organisational decisions affect the distribution of wealth among members of the organisation, and some members try to influence the decision to their benefit. The scale of influence costs will depend on the degree of central authority, the decision-making procedures, and the degree of homogeneity or conflict in the interests of members (Milgrom and Roberts, 1992).

An extensive literature has emerged on the theoretical aspects of cooperatives attempting to illustrate how a different structure of property rights, and, in particular, the introduction of tradable shares in cooperatives or the conversion of cooperatives in joint-stock companies helps to overcome such drawbacks.²⁸

On the problem of ensuring adequate funding for investment, empirical studies of cooperatives do not find conclusive evidence that capital/output or capital/labour ratios are lower than in investor-owned firms (Bonin, Jones and Putterman (1993)). However, the real stumbling block to carrying out such comparisons probably lies in the absence of firm-level data on twin organisations over a reasonable number of years.

In practice to meet this difficulty agricultural cooperatives have introduced a wide variety of financial arrangements.²⁹ Many have recourse to outside investors, even though this may run the risk of loss of control. To reduce such a risk, in Spain, for example, a distinction has been introduced between full members of the cooperative, supporters and collaborators.

Some agricultural cooperatives have introduced bonds (in the Netherlands for example), or transferable shares, while others have been converted in joint stock companies (in Britain and Germany). Shareholders may be members of the cooperative, or, in some cases, outsiders such as other cooperatives, federations of cooperatives, institutional investors, or private individuals. In some countries (such as Sweden) legislation has been introduced to permit at least a part of collective capital to be divided into individual components. In a few cases arrangements have been introduced to reimburse

American model relies on efficient financial markets, with shareholder bids, and the prospect of takeovers as a means of disciplining managers. The German-Japanese model relies more on the relations between firms and their owners (and, in particular, banks which may hold a significant amount of shares) to monitor the behaviour of managers and performance of the firm.

²⁸See, for example, Bonin, Jones and Putterman (1993), or van Bakkum and van Dijk eds. (1997).

²⁹See van Bakkum and van Dijk eds. (1997) for a discussion of these arrangements.

departing members of cooperatives for past contributions to capital by an amount equivalent to the future value of investments.

Turning to the argument that cooperatives with a large number of members encounter difficulties of coordination and control, this would seem to bode ill for cooperatives in the EU, given the high number of mergers and acquisition of other firms which has occurred recently. However, in an extensive survey of cooperatives in each of the EU member States, van Bekkum, van Dijk et al (1997) do not find evidence for this conclusion. Rather, they argue that larger cooperatives with more members are generally better able to deliver the goods, and thereby ensure the loyalty of their members.

The legislation on cooperatives varies considerably between member states, with differences with regard to tax concessions, subsidised credit, norms regulating the structure and behaviour of cooperatives, competition policy and so on. Such differences may create difficulties for the functioning of the Single Market.

Some Member States (and, in particular, the Southern counties, Greece, Italy, Spain and Portugal) offer a various financial incentives for the creation of cooperatives. This may encourage the establishment of cooperatives which simply exist "on paper" to benefit from the various advantages of public support. According to various authors,³⁰ this was a major problem in Southern Italy, where incentives such as tax concessions, subsidised interest rates, and grants were a major reason for rapid increase in cooperatives, in particular, in the 1970s.³¹

A key to increasing the competitiveness of cooperatives in a changing market environment is to ensure that management capabilities are adequate. Remuneration should be adequate to attract skilled and motivated management, and attempts should be made to judge the effectiveness of management performance. The introduction of shares representing the individual member's capital investment with the payment of dividends on these shares on the basis of business performance would also act as an indicator of the degree of success of management.

In practice in many cooperatives equal treatment for members is interpreted to mean equal pricing or charging the same price per unit. With the

³⁰See, for example, Saccomandi (1984) and Giacomini, Bonomi, and Martorana (1996).

³¹In 1951 55% of all cooperatives in Italy were in the North, but the share fell to 25% by 1990 when the percentage of all agricultural cooperatives in the South rose to 51% (statistics from the Ministry of Labour and Social Security). Cooperatives in the Mezzogiorno were frequently also characterised by weak organisation, and low participation in associations coordinating the activities of cooperatives.

increasing emphasis on quality it is necessary to make adequate allowances for product differentiation, which may imply equitable, rather than equal treatment. Similarly, it may be necessary to take into account the fact that larger members of the cooperative generally receive the same price as smaller patrons, though they frequently impose lower costs or contribute more to the net income of the cooperative (van Bekkum and van Dijk eds., 1997).

Given the growing concern of consumers with the safety and quality of foodstuffs, cooperatives should be increasingly concerned with market orientation, imposing tighter conditions and controls on their members. In view of the more demanding requirements of processors and end-users, at times it may also be necessary for cooperatives to introduce more flexible arrangements with non-members, for instance, buying raw material from non-members or establishing autonomous subsidiaries supervised by the holding cooperative for marketing and international operations. According to van Bekkum and van Dijk eds., (1997), such subsidiaries may offer advantages in terms of better financial control, risk reduction, access to market activities, and responsive decision-making.

6. The Agricultural Sector in Cyprus

In 1997 agricultural production in Cyprus accounted for roughly 5% of GDP and 10 % of employment,³² compared to the equivalent EU(15) figures of 2.0% and 5.1% respectively for 1997 (see Table 4). The share of agriculture in Cypriot employment was as high as 45% in 1960. The food-processing industry in Cyprus accounted for a further 13% of GDP and 18% of employment in 1997.

In 1997 crops accounted for 50% of gross agricultural output, and about 66% of value added, while livestock products amounted to 30-36% of gross output and 20-25% of value added. Table 5 provides statistics on production for some of the main product groups.³³

³²Unless otherwise stated, the statistics in this Section are taken from Government of Cyprus (1998) and Commission of the European Communities 1999.

³³The main field crops are barley and fodder crops. Potatoes account for a large part of vegetable production, and pork and poultry are the most important form of meat production. Other important products are citrus fruit, vine products, olives, sheep and goats, and dairy products.

Table 4: The Agricultural Sector in the EU and Cyprus (1997)

	EU	Cyprus
Agricultural land 1000 ha	134,261	200*
average size of holdings ha	17.4	3.5
full-time equivalent workers in agriculture 1000	7,434	29
% agriculture in employment	5.0%	10%
% agriculture in GDP	2.0%	5%

Source: Eurostat and Government of Cyprus (1998)

*1996

Table 5: Production, Trade and Self-Sufficiency of Main Agricultural Products in Cyprus(1996)

(1000t)	cereals	vege- tables and their products	fruit and processed fruit	milk and milk products	meat and meat products	vegetable oils and their products
Production	141	316	337	180	90	11
Imports	593	106	22	32	4	58
Exports	3	19	145	24	3	0
Self-sufficiency 1991-5 (%)	22.68%	n/a	n/a	88.2%	93.27%	
Self-sufficiency 1996	19.4%	78.4%	157.5%	92.8%	98.9%	16.2%

Source: FAO

n/a: not available

Of a total land area of 925,000 hectares, agricultural land was only about 200,000 hectares in 1996.³⁴ Irrigated land, which permits the intensive production of fruit trees, vines, citrus fruit and vegetables amounts to only 20% of agricultural land.³⁵ Although irrigated crops cover such a small percentage of cultivated land, in terms of value they account for 60-70% of total crop production (Gans, 1996). The scarcity of water, and the falling annual precipitation represent major problems.

³⁴The remaining land is arid, uncultivated or forest.

³⁵Government of Cyprus (1999).

A further difficulty is the small size of farms. The average size of holdings in 1997 was 3.5 hectares,³⁶ and 30% of all holdings were less than one hectare, a further 30% of 1-2.5 hectares, and 24% between 2.5 and 8 hectares. Moreover, the average size of holding has been falling (from 4.58 ha in 1977), largely as a result of the inheritance system.

In addition, farms tend to be fragmented and dispersed, and on average each Cypriot holding was divided into 4.5 plots. Often these plots are scattered all over the village, or even in distant villages, and in some cases are even without road access. Not only do farmers take time to travel between such plots, but their small size hinders mechanisation and the possibility of exploiting economies of scale.

Part-time farming is negatively correlated with the size of the holding, and is a dominant feature of Cypriot agriculture. There has been an upward trend in land purchase by town dwellers.

As Gans (1996) describes, although almost all land is privately owned, a number of legal problems relating to property rights arise. In 1985 some 22% of land was owned by more than one person, largely as a result of the inheritance system and land tenure law which prevent the division of plots below a certain minimum size. In some cases there is separate ownership of land, trees and water on a single plot, while in other cases land lacks title deeds. There is also a lack of legislation covering long-term leasing of land.

7. Agricultural Trade

Agricultural products account for 20% of all exports, and the EU is the main trading partner, and was the destination of 87% of Cypriot agricultural exports in 1997. Within the EU, Britain is the main destination of agricultural exports, as, at least initially in the 1960s, many exports arose to meet the demand of Cypriot expatriates there (Gans, 1996).

Irrigated crops figure strongly in exports, and, in particular, potatoes, citrus products, fresh grapes and vegetables. Processed products account for a further 11% of exports and include processed fruit and vegetables, wine and spirits and milk products.³⁷ According to the Government of Cyprus (1999, p.7), the geographical position of Cyprus should offer an advantage in permitting out-of-season exports to the EU.

³⁶Not only is this below the EU average of 17.4 ha, but it is also below that of all EU countries, with 4.5 ha for Greece, 6.9 ha for Italy, 38.5 ha in France and 70.1 ha in the UK.

³⁷ Including the famous *halloumi* cheese.

Cyprus remains a net importer of agricultural products, and in particular, of cereals, beef, lamb, milk products and processed food items.³⁸ In years of bad harvest such as 1991, the overall agricultural trade balance tends to be negative, as exports raw agricultural products may fail to offset imports of processed products (Gans, 1996). Livestock production is heavily dependent on imported foodstuffs, and, in contrast to fruit and vegetables, can be regarded essentially as an import-substituting sector.

Cyprus signed a customs union agreement with the EU in 1973, which entered into its second and final stage from 1987. As a result, tariffs on agricultural products covered by the agreement have been abolished, while preferential treatment has been granted for products not included in the customs union.³⁹ When Cyprus joins the EU it will therefore be moving from a customs union (which does not cover many agricultural products) to an (albeit imperfect) single market.⁴⁰

As a result of the 1994 GATT Uruguay Round Agreement, the former system of quotas or import prohibitions for agricultural products was abolished, and tariffication (i.e. the transformation of non-tariff barriers into tariffs) was implemented. The resulting bound rates are similar to those of the EU, though in some cases higher.⁴¹

8. Adapting Cypriot Agricultural Policy to the EU

In the past agricultural policy in Cyprus was highly interventionist, but in recent years there have been attempts to bring measures increasingly in line with EU market organisations.

The Cypriot government sets wholesale and retail prices and margins for many agricultural products,⁴² and statutory marketing boards control the internal and external marketing of products, such as milk, olive oil, carrots, potatoes, and beetroot.⁴³ Direct subsidies are given to various products, while indirect

³⁸See Table 5.

³⁹Tariffs have been abolished on many products included in Annex IV to the agreement, such as fruit, vegetables and wine. Cyprus has granted improved market access for products such as cereals, oils, milk and meat products and fish, and has applied a preferential tariff on all other products not included in the customs union (Government of Cyprus, 1999)

⁴⁰On the enlargement question many observers tend to assume erroneously that the applicant country starts from a free trade situation.

⁴¹European Commission (1998).

⁴²The Ministry of Commerce and Industry also fixes maximum trade margins for wholesaler and retailers on products not covered by government agencies or cooperatives.

⁴³The aims of marketing boards include the creation of more orderly and more economical marketing structures, ensuring continuity of supply, improving quality, and increasing bargaining power vis-à-vis processors.

support to agriculture is also provided through the supply of subsidised irrigation water.⁴⁴

When Cyprus joins the EU, it will have to abolish the various state-controlled commissions and marketing boards as exclusive marketing arrangements are forbidden in the EU. In the past, the treatment of marketing boards when a country joins the Community has proved a contentious issue.

This was the case for Britain's milk marketing boards which had been established in the 1930s and bought nearly all milk sold from farms to sell it on to processors. The boards were also active in the improvement of quality standards. Other Member States that feared that the milk marketing boards could exploit their monopolistic position and price pooling policy as a means to undercut the price of imports. In 1978 a political compromise was reached⁴⁵ which entailed that "a Member State might be authorized to grant to an organisation representing at least 80% of the number and at least 50% of the production of the milk producers...a) the exclusive right to buy from producers...b) the right to equalise the prices paid to producers". (Harris, Swinbank and Wilkenson, 1983). In 1994 the milk marketing boards passed from being government-funded bodies to becoming autonomous cooperatives representing all producers in England, Scotland and Wales.⁴⁶ A similar option could be introduced in Cyprus.

As an EU member Cyprus would have to end the subsidisation of irrigation water which would violate EU competition law. In addition, subsidies on cereals and hay, the direct subsidy to vine growers, the fixed margins for retail and wholesale prices would have to be eliminated or restructured to bring them into line with the CAP (Pattichis, 1999).

Following the 1993 European Commission's Opinion on Cyprus's application for membership, working groups were established to assess what measures were necessary to bring Cypriot agriculture in line with the *acquis*.⁴⁷ In 1997 this led to the beginning of a harmonisation programme, and to a process of more systematic screening of the *acquis*. Emphasis was placed on the process of adopting EU quality standards and health regulations, on measures to increase productivity, and on the necessary institutional changes, including the introduction of CAP-like mechanisms for organising markets.

⁴⁴Gans (1996) estimated that farmers pay no more than one third of average unit cost for water.

⁴⁵This entailed a modification to Reg. 804/68

⁴⁶These cooperatives are Milk Marque, Scottish Milk and United Milk Producers.

⁴⁷Government of Cyprus (1999).

As an EU member Cyprus would qualify for transfers from the Community Budget through the structural funds.⁴⁸ EU structural measures related to agriculture include those aimed at promoting rural development, more environmentally-friendly agriculture, early retirement, the structural adjustment of farms, and forestry measures.⁴⁹

The reform of the CAP agreed at the Berlin European Council of March 1999 (also known as "Agenda 2000" which was the title of the Commission's initial proposals of 1997) entails reductions in intervention price of 15% for cereals and dairy products, and of 20% for beef. Farmers in the EU (15) would be partially compensated for these price cuts through direct payments. Milk quotas would continue until 2006 and compulsory set-aside (i.e. the obligation to leave a certain percentage of land idle) would be set at a default rate of 10%.⁵⁰

There has been considerable debate about how far (or whether) direct income payments should be extended to farmers in countries joining the EU. At least initially such payments were introduced as compensation for the loss of income resulting from the reductions in price support resulting from the 1992 MacSharry reform and the Berlin Agreement. At first the Commission argued that farmers in applicant countries will generally not experience price cuts and

⁴⁸These are transfers to the less favoured areas and sections of the population of the EU. The structural funds are the European Social Fund, the European Regional Development Fund, the Guidance Section of FEOGA (the European Fund for Agricultural Guidance and Guarantee, and the Guidance Instrument for Fisheries. A related measure is the Coherence Fund for member states whose per capita GDP is less than 90% of the EU average.

⁴⁹Over the 1994-1999 period such measures fell under Objectives 1, 5a and 5b of the Structural Funds, but under Agenda 2000 the number of Objectives is reduced to three. Objective 1 applies to regions whose GDP is less than 75% of the EU average. Objective 2 concerns regions with major economic and social restructuring needs. Objective 3 is a "horizontal" measure concerned with the development of human capital, and applying in all regions not covered by Objectives 1 and 2. Its aim would be to help member states adapt and modernise their education, training and employment.

According to the financial perspective for the period 2000-2006, the structural funds will account for 31% of the EC Budget and 0.46% of EU GDP. On average GDP per capita in the applicant countries is lower than in the EU(15). To limit the scale of transfers from the Community Budget, the Berlin Agreement therefore placed a ceiling on the size of the transfer to countries joining the EU of 4% of the GDP of the recipient country.

⁵⁰It could prove difficult to implement and enforce supply-control measures such as the compulsory set-aside of land and production quotas on milk in the applicant countries. In Cyprus and (following privatisation) the CEECs many holdings are small and fragmented, and are often owned by non-farming landowners. Small farms can opt for the simplified regime (which applies to farmers requesting compensation for less than 92 tonnes of cereals) and so avoid the obligation to take land out of production. This could create tensions and render set-aside even less effective as a supply-control measure (Buckwell et al.).

so should not benefit from direct payments,⁵¹ and only in early 2000 was the possibility of extending those payments to the applicant countries voiced.

Even after the Berlin Agreement EU agricultural producer prices are likely to be higher in than those in Cyprus and on world markets.⁵² When the CAP is extended to Cyprus, farm gate prices for many products are therefore likely to increase. If these higher farm gate prices are passed on as higher retail prices they will entail an additional burden for consumers.⁵³ As a net importer of cereals and livestock Cyprus will also have to pay higher prices for these imports. These price increases are likely to affect poorer households most as they generally spend a higher percentage of their income on food. Against this, however, it is necessary to consider the expected positive impact on income EU accession is expected to have in stimulating economic growth overall.

The higher farm gate prices expected as a result of adopting the CAP could also have a negative impact on the food industry in Cyprus. If the higher prices for agricultural inputs paid by the food industry cannot be passed on to consumers because of competition from foreign, or more efficient processors, some firms may be forced out of business.⁵⁴ At the same time in an enlarged single EU market Cypriot food industry will have to compete with EU firms, and *"some of the the world's most efficient food industries operate in the EU 15"* (European Commission, 1997, p.15).

Squeezed between higher prices for their agricultural inputs, and increased competitive pressures from EU firms, it is imperative for the Cypriot food industry to adjust and restructure in order to raise its competitiveness. This restructuring could involve cutting costs and increasing efficiency, or improving quality and increasing value added. Higher farm gate prices are likely to have consequences for the marketing strategies of Cypriot farmers. Also here, improvements in efficiency are the key to competing in an enlarged EU market and it is in this context that the promotion of cooperatives could play a role.

9. The Experience of Cooperatives in Cyprus

Cooperatives have played an important role in Cyprus in the provision of credit and inputs and in the marketing of products (see Table 6). It is estimated that

⁵¹See, for example, the 1995 Agricultural Strategy Paper (Commission of the European Communities, 1995), and Agenda 2000 (Commission of the European Communities, 1997).

⁵²Cypriot cereal prices represent an exception as producer prices are higher than in the EU, though consumer and import prices are lower than those of the EU.

⁵³In welfare terms, consumer surplus falls while producer surplus increases. For estimates of the size of these effects in the case of Cyprus see Pattichis (1999).

⁵⁴For a more detailed discussion of this issue see European Commission (1997).

cooperatives account for the provision of about 80% of fertilisers and roughly a third of chemicals.⁵⁵ They also market about one third of all fruit and vegetables, and are consulted by wholesalers in the setting of prices.

Table 6: Number of Registered Cooperatives in Cyprus by Type of Activity (1997)

Type of economic activity	Number of cooperatives	Distribution by type of activity (%)
Marketing of agricultural products	32	6.7%
Manufacturing		
- processing of agricultural products	6	1.3%
- processing of non-agricultural products	3	0.6%
Retailing	58	12.2%
Credit and savings	363	76.3%
Insurance	1	0.2%
Other services*	13	2.7%
Total	476	100%

Source: Government of Cyprus, 1999

* These include cooperatives for a medical fund, government lottery ticket salesmen, land leasing, water provision, transport and tourist services, computer services, and concentration of cereals.

Credit for agriculture comes from commercial banks (about 71%), the village cooperative societies (27%), and, to a much lesser extent, the Cyprus Development Bank.⁵⁶ The village cooperative societies are the main source of credit for small farmers. The cooperative societies are obliged to make deposits in the Central Cooperative Bank, while the latter grants subsidized long-term credit to farmers. However, there are frequent complaints about slow and complex administrative procedures, and delays in the disbursement of subsidised credit.

The SEDIGEP Cooperative Marketing Union plays an important role in the marketing of citrus fruits, grapes and watermelons. In 1999 it was composed of 3568 individual members and 22 cooperatives. The SEDIGEP is responsible for about half of all grape exports and 25-30% of those of citrus fruits, with most of the remaining export shares of these products being handled by private firms. Before the marketing boards for potatoes, carrots and beetroots, the SEDIGEP was also responsible for marketing these products, and it is still actively involved in their packaging for export.

⁵⁵The statistics in this paragraph are taken from Government of Cyprus (1999).

⁵⁶This is a government institution which does not accept deposits and does business exclusively with large enterprises. The percentages here are taken from Gans (1996).

Table 7 indicates the scale of activity of some of the main cooperatives involved in the processing of agricultural products in Cyprus.

Table 7: Some of the main cooperatives involved in the processing of agricultural products in Cyprus

	Turnover in 1997 (CY£ million)	Market share
The Cooperative for the Marketing of Vine Products	5.9m.	30%
The Cooperative for the Processing of Agricultural Produce	3.6m.	n.a.
The Cooperative of Tobacco Producers	1m.	n.a.
The Cooperative for Animal Feedstuffs	3.3m.	14%

n.a. - not available

Source: Government of Cyprus, 1999

10. How cooperatives could help Cyprus to prepare for EU accession

It is useful to summarise the various ways in which measures to favour the creation of cooperatives might facilitate the process of EU accession:

- overcoming the disadvantages of small, fragmented farms by helping to concentrate supply, stabilise producer prices, and increase the bargaining strength of farmers;
- permitting farmers to exploit economies of scale and increasing their capacity to compete on an enlarged market. This could help to offset the negative consequences of higher prices for consumers and the food industries in Cyprus.
- easing the process of adopting the *acquis* and, in particular, the task of taking on EU standards with regard to food safety, and health concerns;
- improving quality and increasing market orientation, thereby helping to meet the growing requests of consumers for variety, convenience and specialised regional foodstuffs;
- improving standards for grading, packing and storage;
- replacing the marketing boards;
- ensuring that producer organisations in sectors such as fruit and vegetables operate more effectively.

In promoting agricultural cooperatives care must be taken to overcome certain drawbacks by:

- ensuring that government incentives do not lead to the creation of cooperatives which exist on paper, but which fail to operate effectively in practice;
- overcoming the problems of corporate governance which may arise from diverging objectives of the owners (members) and managers of the cooperative;
- treating members in a fair, though not necessarily identical manner;
- improving the quality of management;
- increasing market orientation;
- ensuring adequate funds for investment.

As the discussion of the experience of agricultural cooperatives in the EU has shown, many of these disadvantages can be avoided by introducing an appropriate legislative framework, by encouraging cooperatives to adopt innovations in their organisational structure such as transferable shares, or external financing, and by attaching higher priority to the quality of management, and the need for market orientation.

Susan Senior Nello
 Università degli Studi di Siena
 Department of Political Economy

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